Supreme Court, U.S.
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No. ____

In the Supreme Court of the United States

Boulder Fruit Express, Health & LeJeune, Heger Organic Farm Sales, Mountain Gold, Inc., New Harvest Organics, Pacific Organic Produce, S.A., American 4-Star Marketing, Inc., d/b/a Rainbow Valley Orchards, and Sundance Natural Foods,
Petitioners,

v.

Transportation Factoring, Inc., a Utah corporation, d/b/a Transfac, and Capitol Resource Funding, Inc.,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Does the decision of the U.S. Court of Appeals for the Ninth Circuit conflict with the decisions of other U.S. Courts of Appeals on similar issues?

2. Has the U.S. Court of Appeals for the Ninth Circuit decided an important question of federal law which has not been, but which should be, settled by the Supreme Court?

PARTIES TO THE PROCEEDINGS

I. Petitioners. Petitioners are as follows: Boulder Fruit Express, Heath & Lejeune, Heger Organic Farm Sales, Mountain Gold, Inc., New Harvest Organics, Pacific Organic Produce, S.A., American 4-Star Marketing, Inc., d/b/a Rainbow Valley Orchards, and Sundance Natural Foods. Boulder Fruit Express is a division of Alberts Organics, Inc., a closely held corporation. None of Petitioners is owned by a parent company, and none of Petitioners owns any subsidiary companies. Petitioners are represented by the following counsel:

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II. Respondents. Respondents are Transportation Factoring, Inc., d/b/a Transfac, and Capitol Resource Funding, Inc.

III. Other Parties. John Mesing, individually and d/b/a Certified Organics, First Interstate Bank (LA), Luke Patruno, Jr., and Western Mixers, Inc., were each

defendants in the underlying action before the District Court but took no part in the proceedings before the Court of Appeals and have no interest in the outcome of this Petition. In addition, Natural Selection Foods, LLC, and Continental Sales Company, were plaintiffs in the underlying action before the District Court and appellants in the proceedings before the Court of Appeals but have not joined in this Petition.

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Petitioners Boulder Fruit Express, Heath & Lejeune, Heger Organic Farm Sales, Mountain Gold, Inc., New Harvest Organics, Pacific Organic Produce, S.A., American 4-Star Marketing, Inc., d/b/a Rainbow Valley Orchards, and Sundance Natural Foods ("Petitioners") respectfully request this Court to issue a writ of certiorari to review the judgment entered in this case by the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The opinion of the Court of Appeals on the merits is reported as *Boulder Fruit Express v. Transportation Factoring, Inc.*, 251 F.3d 1268 (9th Cir. 2001), and is reproduced in the Appendix at 1a. The opinion and order of the U.S. District Court for the Central District of California granting Appellees' Motion for Summary Judgment is reported as *Boulder Fruit Express v. Mesing*, 1998 U.S. Dist. LEXIS 22887 (C.D. Cal. 1998), and is reproduced in the Appendix at 15a. The opinion and order of the District Court modifying and finalizing its Order granting Appellees' Motion for Summary Judgment is reported as *Boulder Fruit Express v. Mesing*, 1999 U.S. Dist. LEXIS 21830 (C.D. Cal. 1999), and is reproduced in the Appendix at 10a. The decision of the Court of Appeals denying Petitioners' Petition for Rehearing En Banc is unreported and is reproduced in the Appendix at 31a.

STATEMENT OF JURISDICTION

The U.S. Court of Appeals for the Ninth Circuit issued its Opinion affirming the District Court's ruling on June 4, 2001. Petitioners filed a timely Petition for Rehearing En Banc and the Court of Appeals entered an order denying same on September 18, 2001. Petitioners have not requested

or been granted any extension of time in which to file their Petition for Writ of Certiorari. Petitioners now invoke the jurisdiction of the Supreme Court pursuant to 28 U.S.C. § 1254(1).

STATUTES PERTAINING TO THE QUESTIONS PRESENTED

The applicable provisions of the PACA are as follows:

(1) It is hereby found that a burden on commerce in perishable agricultural commodities is caused by financing arrangements under which commission merchants, dealers, or brokers, who have not made payment for perishable agricultural commodities purchased . . . encumber or give lenders a security interest in such commodities . . . and any receivables or proceeds from the sale of such commodities or products, and that such arrangements are contrary to the public interest. This subsection is intended to remedy such burden on commerce in perishable agricultural commodities and to protect the public interest.

(2) Perishable agricultural commodities received by a commission merchant, dealer, or broker in all transactions, and all inventories of food or other products derived from perishable agricultural commodities, and any receivables or proceeds from the sale of such commodities or products, shall be held by such commission merchant, dealer, or broker in trust for the benefit of all unpaid suppliers or sellers of such commodities . . . until full payment of

> the sums owing in connection with such transactions has been received by such unpaid suppliers, sellers or agents.

7 U.S.C. § 499e(c)(1)-(2).

In addition, the regulations implementing PACA define the trustee's duty as follows:

> [c]ommission merchants, dealers and brokers are required to maintain trust assets in a manner that such assets are freely available to satisfy outstanding obligations to sellers of perishable agricultural commodities. Any act or omission which is inconsistent with this responsibility, including dissipation of trust assets, is unlawful and in violation of [PACA].

7 C.F.R. § 46.46(d)(1). The regulations define "dissipation" as follows:

> any act or failure to act which could result in the diversion of trust assets or which could prejudice or impair the ability of unpaid suppliers, sellers, or agents to recover money owed in connection with produce transactions.

7 C.F.R. § 46.46(a)(2).

STATEMENT OF THE CASE

I. Statement Of Facts.

Petitioners are all unpaid suppliers of perishable agricultural commodities ("Produce") to Certified Organics

("Certified"), the main defendant before the District Court. Certified entered into a factoring agreement with Transportation Factoring, Inc., d/b/a Transfac ("Transfac"), under which Transfac loaned money or made advances to Certified. Excerpts of Record, pp. 759-60. In exchange, Certified granted Transfac various security interests and other rights in and to Certified's Produce-generated accounts receivable (the "Receivables"). *Id.*, pp. 760. While the factoring agreement contained a self-serving characterization of the transaction as an outright "sale" of Certified's Receivables to Transfac, at a twenty percent (20%) discount of the face value thereof, Transfac retained rights of recourse as to any uncollectible accounts and Certified retained all "risk of loss" if the Receivables were not collectible. *Id.*, pp. 155-62. In addition, Transfac charged Certified interest or a "handling fee" on the alleged purchase price or advance based upon the time the advance was outstanding. *Id.*

During the proceedings before the District Court, Transfac admitted acquiring rights in Certified's Receivables which had an invoice value of approximately $4.7 million. *Id.*, pp. 148-49. Against this amount, Transfac asserted it had made advances to Certified totaling approximately $3.3 million. Transfac recovered almost as much on the Receivables, which Transfac applied to satisfy the outstanding account balance due from Certified. *Id.*

In addition, the owner of Certified submitted an affidavit stating that on numerous occasions during the life of the factoring agreement, he had advised Transfac the PACA trust had been breached because the sums Transfac was "advancing" to Certified for the Receivables were not sufficient to enable Certified to pay its Produce suppliers in full. *Id.*, p. 760. Transfac's response was to amend the factoring agreement to double the "reserve," from twenty

percent (20%) to forty percent (40%), thereby advancing only sixty percent (60%) to Certified for new Receivables thereafter assigned to Transfac instead of the original eighty percent (80%). *Id.*, pp. 761, 1111. In addition, Transfac demanded additional security for these "advances" in the form of a lien on Certified's real property. *Id.*, p. 761. Transfac also cross-collateralized each advance by applying proceeds recovered from Certified's accounts which did pay against advances made on other of Certified's accounts which had failed to pay. *Id.*

In April 1997, after one of Certified's unpaid produce suppliers advised Transfac in writing of Certified's breach of the PACA trust, Transfac began foreclosing on its interest in Certified's Receivables by collecting directly from each of the account debtors. *Id.*, pp. 1113-15. Transfac issued a written demand to all of Certified's account debtors to pay all sums due Certified directly to Transfac pursuant to the factoring agreement. *Id.*, pp. 1115-16. Transfac also asserted its rights under the agreement to divert all mail addressed to Certified to Transfac's offices in order to directly recover all checks issued and mailed to Certified. *Id.*, pp. 1116-17.

II. The Proceedings Below.

A. The District Court.

Petitioners brought their claim against Certified for breach of the PACA trust and also named Transfac and Capitol Resource Funding, Inc. ("CRF")(Transfac and CRF are collectively referred to as the "Factors") as defendants. According to the express language of § 499e(c)(2) of the PACA, the Receivables which the Factors collected were all clearly assets impressed with, and constituting the corpus of, the PACA trust. The Factors defended against Petitioners'

prior interest in the Receivables by contending the Factors were "bona fide purchasers" ("BFPs") of these trust assets.

The Factors moved for summary judgment on their BFP defense to prevent disgorgement of these PACA trust assets they had received ahead of the unpaid beneficiaries of the PACA trust, including Petitioners. In opposing the motion, the Petitioners submitted an affidavit from Certified's owner, the PACA trustee, averring he had given notice of the breach of trust to the Factors, while the Factors offered a counter-affidavit denying such notice. The District Court granted the Factors' motion for summary judgment, even though even though these affidavits clearly demonstrated a triable issue as to what the Factors knew and when, and Petitioners appealed to the Ninth Circuit.

B. The Court Of Appeals.

The Court of Appeals affirmed the District Court's order granting summary judgment in favor of the Factors. *Boulder Fruit*, 251 F.3d at 1272. Although the Court of Appeals correctly held that general trust principles govern cases in which the enforcement of the PACA trust is at issue, the Court then failed to apply one such crucial principle, namely, that non-trust beneficiaries can only receive trust assets ahead of unpaid trust beneficiaries by proving their BFP status. Thus, in order to retain PACA trust assets ahead of the unpaid PACA trust beneficiaries, such as Petitioners, Transfac should have been required to prove it qualified as a BFP of these assets. However, rather than addressing the issue of whether Transfac had done so before the District Court, the Court of Appeals instead determined there had been no breach of the PACA trust, and therefore, the Court had no reason to consider the issue of Transfac's status as a BFP. *Id.*

In essence, the Court of Appeals ruled on an argument which Petitioners did not make, namely, that the mere execution of a factoring agreement between Certified and Transfac was a *per se* violation of PACA. The Court went even further, accepting the Factors' argument that the factoring agreement in this case "actually enhanced the trust because it was commercially reasonable." *Id.* Thus, the Court determined that "[t]he only question in this case is whether Certified breached its duty as a trustee when it sold the accounts receivable to Transfac" – a mere threshold question which the Court had already answered in the negative. *Id.*

In so ruling, the Court never reached the *real* issue before it, which was whether Transfac had notice of any breach of trust prior to the time Transfac recovered upon its collateral which secured the "advances." Under the general trust principles which the Court professed to recognize, any receipt of trust assets by a non-trust beneficiary is wrongful unless the transferee can prove BFP status. Therefore, the issue of whether Certified breached the PACA trust merely by entering into the factoring agreement was only the beginning of the relevant analysis. Because Transfac clearly continued to receive trust assets under the factoring agreement long *after* the agreement was executed, Transfac should have been required to prove its status as a BFP while it was collecting the receivables, not just at the time the agreement was executed.

Instead of doing so, the Court began and ended its analysis by finding that the factoring agreement was "commercially reasonable" and did not, by itself, result in a breach of the PACA trust. Based on its conclusion that there was no breach of trust, the Court further determined there was no reason to examine Transfac's status as a BFP for any

subsequent payments it diverted from Certified.

In addition to overlooking Certified's continuing breach of the trust by failing to pay Produce vendors such as Petitioners, the Court's conclusion is also at odds with the decisions of other Courts of Appeals in cases based on nearly identical facts. The Court's ruling thus creates uncertainty in the lower courts by establishing two divergent standards for interpreting the PACA trust provisions where a secured lender is competing with PACA trust beneficiaries. The ruling also condones the use of the exact "financing arrangements" which Congress enacted this remedial statute to prevent.

REASONS FOR GRANTING THE WRIT

I. The Court Of Appeals' Failure To Consider Whether Transfac Had Notice Of Certified's Breach Of The PACA Trust Creates A Conflict With The Rulings Of Other Circuits In Cases Based On Similar Facts.

A. Breach Of The PACA Trust.

In the instant case, Certified entered into a factoring agreement with the Factors under which the Factors loaned money or made advances to Certified in return for a security interest in Certified's Receivables. While the factoring agreement was characterized as a "sale" of the Receivables to Transfac, Certified always retained the risk of loss on the Receivables. Transfac charged Certified interest and fees on these "advances" and even had the right to demand additional security if Transfac ever felt its "advances" were in danger of becoming unrecoupable. Nonetheless, the Court found the transaction "commercially reasonable" from Certified's point of view, and based thereon, concluded Certified had not

breached the PACA trust by the mere execution of the factoring agreement. *Boulder Fruit*, 251 F.3d at 1272. Even though this was not the issue before the Court on Petitioners' appeal, the Court held that once the factoring agreement was found to be reasonable, there was nothing else to consider. *Id.*

As noted, the Court began and ended its analysis as of the time Certified and Transfac executed the factoring agreement, determining that since Certified turned its Receivables, or "future funds," into "current funds," which could then be used to pay its growers, there was no breach of trust. By ignoring the fact that Certified was simply borrowing against its Produce-generated accounts receivable, the Court seems to have concluded that because Transfac "advanced" funds to Certified which Certified might have then used to pay some of its unpaid growers (though clearly not Petitioners), there could not then be any subsequent breach of the trust. However, the Court overlooked the simple fact that Certified did not pay the Petitioners and other suppliers for the Produce they sold to Certified. By its very nature, Certified's failure to pay the Petitioners and other Produce suppliers constituted a breach of the PACA trust. However, the Court of Appeals ignored this issue along with the obvious fact dispute arising from the competing affidavits concerning whether Certified told the Factors of this breach of trust prior to the time the Factors collected many of the Receivables. The Court also ignored the preliminary question of when a Produce debtor discharges its obligation to the PACA trust.

In *In re Kornblum & Co.*, 81 F.3d 280 (2nd Cir. 1996), the Second Circuit noted that the PACA trust arises from the date the debtor first deals in Produce and does not terminate until all trust beneficiaries are paid in full.

Kornblum, 81 F.3d at 286. In so ruling, the Court specifically addressed concerns over the PACA trust's effect on commercial lending by stating:

> [w]e note the district court's concern that the [trust beneficiaries'] interpretation of PACA would effectively preclude Produce Debtors 'from obtaining secured loans on warehouse equipment, furniture, trucks and any other real or personal property'. This is a legitimate policy consideration that might be advanced in support of an amendment to § 499e(c)(2), but it does not dissuade us from our reading of the statute as presently written.

Kornblum, 81 F.3d at 286 n.3 (citations omitted). *See also* 7 U.S.C. § 499e(c)(2)(trust assets shall be held in trust for the benefit of all unpaid suppliers or sellers "until full payment of the sums owing in connection with such transactions has been received by such unpaid suppliers, sellers or agents"). As the Second Circuit clearly recognized, only after the PACA trust claimants are paid in full can there be any distribution of the PACA trust assets to other non-beneficiary creditors, including those claiming security interests in such assets. *Id.*, 81 F.3d at 286 n.3.

Nonetheless, in the instant case, the Court of Appeals concluded:

> [Petitioners] conceded that they did not know how Certified spent the funds it received from Transfac. If, for example, the funds were used to pay off *other* perishable commodities producers, no breach of the trust would have occurred. This is because the PACA trust, by

> definition, is a non-segregated floating trust in which assets of other growers can be commingled.

Boulder Fruit, 251 F.3d at 1272 (emphasis in original). In essence, the Court held that Certified's receipt of funds from Transfac extinguished the possibility of any subsequent breach of the PACA trust, even though Certified still had unpaid suppliers. Clearly, this is an incorrect statement of the law, since as long as there are *any* unpaid suppliers, the trust still exists and can therefore be breached. More fundamentally, this ruling conflicts not only with the rulings of other circuits, but with the plain language and stated purpose of the PACA statute itself.[1] Even if the Court was correct in surmising that Certified used the Transfac advances to pay some suppliers, the trust was still in effect as to other suppliers, such as the Petitioners. Moreover, Certified not only breached the trust by *initially* failing to maintain sufficient assets to pay Petitioners, that same breach continues through the present date since the Petitioners have still never been paid for the

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[1] In addition to the Second Circuit, at least eight other circuits – including the Ninth Circuit prior to *Boulder Fruit* – have relied upon 7 U.S.C. § 499e(c)(2) in recognizing the PACA trust continues in existence until all growers and suppliers are paid in full. *See Hiller Cranberry Products, Inc. v. Koplovsky*, 165 F.3d 1, 5 (1st Cir. 1999); *Tanimura & Antle, Inc. v. Packed Fresh Produce, Inc.*, 222 F.3d 132, 136 (3rd Cir. 2000); *Golman-Hayden Co., Inc. v. Fresh Source Produce, Inc.*, 217 F.3d 348, 352 (5th Cir. 2000); *Sanzone-Palmisano Co. v. M. Seaman Enterprises, Inc.*, 986 F.2d 1010, 1012 (6th Cir. 1993); *Greg Orchards & Produce, Inc. v. Roncone*, 180 F.3d 888, 890 (7th Cir. 1999); *Hull Co. v. Hauser's Foods, Inc.*, 924 F.2d 777, 780 (8th Cir. 1991); *Sunkist Growers, Inc. v. Fisher*, 104 F.3d 280, 282 (9th Cir. 1997); *Frio Ice, S.A. v. Sunfruit, Inc.*, 918 F.2d 154, 156 (11th Cir. 1990).

Produce. Yet Certified resold the Produce it bought from Petitioners, thus creating the Receivables which the Factors collected and applied to satisfy the loan/advance balance which Certified owed the Factors.

As far as the instant appeal is concerned, the District Court and Court of Appeals failed to consider two (2) crucial issues: (i) when Transfac had actual or constructive knowledge of the breach of trust triggered by Certified's failure to pay its growers and suppliers; and (ii) the amount of trust assets Transfac received after it learned the trust had been breached. The first of these issues is the crux of this case, because as shown below, there is no possibility Transfac could be considered a BFP as to any trust assets it received *after* the point in time it learned of the breach of trust. The second merely goes to the measure of damages for the Factors' receipt of trust assets ahead of the trust beneficiaries Congress sought to protect.

The Court's conclusion that there was no breach because Certified *might* have used the "advances" to pay some of its suppliers misses the point. In fact, had Certified used the advanced funds to pay Petitioners, other unpaid suppliers of Produce to Certified would have gone unpaid, and the PACA trust would still exist. The continued existence of the PACA trust was a crucial factual and legal element which the Court of Appeals, in conflict with the reported opinions out of at least eight other circuits, overlooked.

In addition, the Court also overlooked the PACA trustee's admission that it had breached the PACA trust by failing to pay its Produce suppliers. In fact, Court's only acknowledgment of Certified's admission was as follows:

[Petitioners] argue that Certified necessarily

> admitted a breach of the trust when it admitted that it was unable to pay its growers and suppliers of produce. [Petitioners] confuse breach of contract with breach of trust. The only question in this case is whether Certified breached its duty as a trustee when it sold the accounts receivable to Transfac. Certified's *contractual* obligation to pay is not at issue.

Boulder Fruit, 251 F.3d at 1272 (emphasis in original). Thus, the Court of Appeals improperly limited its focus to the execution of the factoring agreement, rather than examining how its performance violated the very purpose of the PACA statute. Again, though, Certified was

> required to maintain trust assets in a manner that such assets are freely available to satisfy outstanding obligations to sellers of perishable agricultural commodities. Any act or omission which is inconsistent with this responsibility is unlawful and in violation of [7 U.S.C. § 499b].

7 C.F.R. § 46.46(d)(1).

Certified admitted its failure to maintain the trust assets in this manner, and thus admitted it acted inconsistently with its responsibility as trustee. Therefore, by definition, Certified admitted it breached the PACA trust when it notified the Factors of the inability to pay the PACA trust beneficiaries. Again, the Court's distinction between Certified's contractual obligations and its duties as the PACA trustee is contrary to the statute and the rulings of other circuits. The same acts and omissions which Certified admitted conclusively established both breaches of contract

and breaches of trust. By admitting to one, Certified necessarily admitted to the other. Thus, the Court overlooked both the fact *and effect* of Certified's admission, as well as the unmistakable material issue of fact which this admission, and the Factors' denial thereof, presented to the Court. Faced with this "breach or no breach" and "notice or no notice" fact disputes, the Court should have reversed the District Court's order granting the Factors' motions for summary judgment.

B. The Necessity Of Proving The Bona Fide Purchaser Defense.

Under general principles of trust law, a non-beneficiary can retain trust assets received after a breach of trust only if the transferee can prove its BFP status. *Sunkist Growers, Inc. v. Fisher*, 104 F.3d 280, 283 (9th Cir. 1997); *C.H. Robinson Co. v. Trust Co. Bank., N.A.*, 952 F.2d 1311, 1316 (11th Cir. 1992). To qualify as a BFP, the transferee has the burden of demonstrating both of two (2) essential elements. First, the transferee must show that it received the trust property "for value," *and* second, that the transferee was "without notice" of the breach of the trust at the time it received the trust assets. *C.H. Robinson*, 952 F.2d at 1314. *See also* Restatement (Second) of Trusts § 284 (1959). In the instant case, the Court found the transaction between Transfac and Certified was "commercially reasonable" from Certified's point of view and thus did not result in a breach of the PACA trust. *Boulder Fruit*, 251 F.3d at 1272. Based thereon, the Court concluded that since Certified had not breached the trust, there was no reason to examine whether Transfac was a BFP.

Several circuits have considered the PACA implications of factoring agreements and other similar financing arrangements in recent years. However, until the

Court of Appeals' decision in the instant case, the Circuits which had considered such "financing arrangements" unanimously held that any transferee claiming PACA trust assets ahead of PACA trust beneficiaries would *first* be required to demonstrate that it was a BFP, *i.e.*, that it had taken such assets both "for value" *and* "without notice" of the Produce debtor's breach of the PACA trust. *See Albee Tomato, Inc. v. A.B. Shalom Produce Corp.*, 155 F.3d 612 (2nd Cir. 1998); *Gargiulo v. G.M. Sales, Inc.*, 131 F.3d 995 (11th Cir. 1997); *Endico Potatoes v. CIT Group/Factoring, Inc.*, 67 F.3d 1063 (2nd Cir. 1995); *Consumers Produce Co., Inc. v. Volante Wholesale Produce, Inc.*, 16 F.3d 1374 (3rd Cir. 1994).

In *Endico*, the Second Circuit affirmed the District Court's decision in *A&J Produce Corp. v. CIT Group/Factoring Inc.*, 829 F. Supp. 651, 656-57 (S.D. N.Y. 1993). In *A&J Produce*, the District Court held that where factors exchanged money for accounts receivable, there was no transfer "for value," and the Court expressly rejected the factor's characterization of the financing arrangement as a "contemporaneous exchange." *Id.*, 829 F. Supp. at 656. In fact, the Court specifically noted "transfers of trust property such as accounts receivable are not for value under traditional trust law." *Id.*, *quoting C.H. Robinson*, 952 F.2d at 1315. The Court properly looked beyond the factor's attempt to elevate form over function and noted, as with the instant case, the factor did not receive cash payments from the Produce debtor,

> but in fact advanced loans and in return took over the accounts receivable of the [debtor] pursuant to the security agreements. Such a transfer is not "for value" and, if [the unpaid sellers] satisfy the other elements of their

> causes of action, [the factor] will not be shielded from liability.

A&J Produce, 829 F. Supp. at 657.

In *Endico*, *supra*, the Second Circuit affirmed the District Court's ruling in *A&J Produce*, and further stated it would look beyond the transferee's self-serving characterization of the assigned receivables as a "contemporaneous exchange" for value and seek to properly determine the substance of the relationship between the lender and the Produce debtor. *Endico*, 67 F.3d at 1068. In doing so, the Court determined, as was the case herein, the transferee had not truly "purchased" the receivables, as alleged, but merely took a security interest in them to secure the payment of the "advances." *Id.* The Court held this determination revolved around which party retained the risk of loss if any of the assigned receivables turned out to be uncollectible. *Id.*, 67 F.3d at 1068-69.

Because the factoring agreement in *Endico* saddled the debtor/PACA trustee with the risk of loss, the Court properly determined the factoring agreement therein was merely a disguised security interest. *Id.* at 1069. Accordingly, the Court held "because [the transferee] held only a security interest in [the debtor's] accounts receivable, and did not purchase those accounts for value, its interest is subject to the rights of the PACA trust beneficiaries." *Id.* *See also E. Armata, Inc. v. Platinum Funding*, 887 F. Supp. 590 (S.D. N.Y. 1995).[2]

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[2] In *Armata*, a district court case also from the Second Circuit, the Court held the transfer of accounts receivable based on a sixty-six percent advance was not "for value," finding

In *Albee Tomato, Inc. v. A.B. Shalom Produce Corp.*, 155 F.3d 612 (2nd Cir. 1998), the Second Circuit reversed the District Court's finding that the transferee lender had established its BFP defense as a matter of law. *Id.* at 618. The Court's reversal was based on the District Court's *failure to determine* whether the lender "had actual or constructive notice of the breach of trust." *Id.* at 616. Incredibly, the very issue which the District Court and the Court of Appeals overlooked in the instant case is the exact same issue the Second Circuit characterized, on similar facts, as "the nub of the case." *Id.* In order to resolve this issue, the Court in *Albee* placed the burden of proof squarely on the lender, since the lender "was the moving party as to the bona fide purchaser defense, [and] it was also the party that bore the burden of proof" on that issue. *Id.* at 617. On the facts

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the transfer of receivables in exchange for "advances at a [a discount to invoice face value] under the Factoring Agreement . . . whether denominated as sales of the accounts receivable, or loans by a secured creditor . . . do not constitute transfers for value. [The Factor], under this discount arrangement, cannot be considered a bona fide purchaser." *Id.*, 887 F. Supp. at 529. The Court found the trustee

> was not transferring the accounts for value but at a discount to raise funds and expand the business of the [Produce debtor] rather than to maintain assets that could satisfy the [trust] fund's obligations.

Id. at 594; *accord Post & Taback, Inc. v. Merrill Lynch Bus. Fin. Services*, 859 F. Supp. 757, 758-60 (S.D. N.Y. 1994)(transferor's offer to "sell" the Produce-generated receivables at a discount put the transferee on notice of transferor's breach of trust, thus precluding a finding that the transferee was a BFP).

before it, the Court adopted the following test:

> [w]here, as here . . . the PACA trustee has self-evident cash-flow problems, a lender extending a line of credit to the trustee can obtain status as a bona fide purchaser only by meeting the following test. The lender must make the kind of inquiry as to debts owed by the trustee to PACA beneficiaries that a reasonably prudent lender would make as to debts owed by a similar borrower to a prior creditor who had rights superior to those sought by the lender. We adopt this test because PACA in fact bestows just such superior rights on the beneficiary suppliers and the test has the benefit of being one familiar to lenders.

Id. The Court even "appreciate[d] that PACA trustees may find it difficult to obtain credit under this test, but any statute that gives a class of general creditors priority over secured lenders may have that effect." *Id.* at 617 n. 1.

In addition, the Eleventh Circuit considered a case which was factually similar to, but procedurally the opposite from, the instant case in *Gargiulo v. G.M. Sales, Inc.*, 131 F.3d 995 (11th Cir. 1997). In that case, the plaintiff sued a secured lender which had taken trust assets pursuant to agreement granting the lender a security interest in the produce debtor's receivables in return for advances of between seventy and eighty percent of the invoice amounts. *Id.* at 997. The District Court granted summary judgment in favor of the plaintiff and against the bank on the bank's attempt to claim BFP status. *Id.* at 998. The Court of Appeals reversed on the grounds that the District Court had

not adequately considered "whether the bank was a bona fide purchaser and whether the bank was without notice of [the debtor's] breach of the PACA trust." *Id.* at 1000.

In particular, the Court noted that

> questions remain concerning the bank's policy change with regard to [the debtor], specifically whether the bank reduced the amount that it advanced to [the debtor] against its accounts receivable from eighty percent to seventy percent and, if so, its reasons for doing so.

Id. The Court also concluded that the District Court should have considered whether the bank had discharged its *duty to inquire* as to the debtor's financial problems, and whether the discharge of such duty would have revealed the debtor's breach of the PACA trust. *Id. See also Consumers Produce, supra*, 16 F.3d at 1382 (adopting the standard set forth in the Restatement (Second) of Trusts § 297(a) for determining whether a secured lender has notice of a Produce debtor's breach of the PACA trust).

In the instant case, by contrast, the Court of Appeals entirely dispensed with this well-reasoned analysis. The Court determined that "[w]hether a transferee of trust assets is a bona fide purchaser becomes relevant *only* as a defense *after it has been determined that a breach of trust has occurred.*" *Boulder Fruit*, 251 F.3d at 1272 (emphasis added). In support for this proposition that the Court must find a breach before considering the BFP defense, the Court cited, in addition to the Restatement (Second) of Trusts, to *Albee*, *Gargiulo*, *Endico*, *Consumers Produce* and *C.H. Robinson*. Interestingly, not a single one of these decisions even mentions, much less adopts, the Court's proposed

method of analyzing this issue. In fact, in *Albee* and *Gargiulo*, the reviewing courts reversed the district courts' granting of summary judgment *precisely because* the district courts failed to sufficiently consider whether the secured lender had sustained its burden of proof on the BFP issue. *Albee*, 155 F.3d at 618; *Gargiulo*, 131 F.3d at 1000. In the other three decisions, the reviewing courts affirmed summary judgment in favor of the PACA creditors (*Endico*) or the lenders (*Consumers* and *C.H. Robinson*) *only after* determining the lower courts *had* properly and thoroughly considered the BFP issue to the reviewing courts' satisfaction. *Endico*, 67 F.3d at 1069; *Consumers Produce*, 16 F.3d at 1383; *C.H. Robinson*, 952 F.2d at 1316. Again, nothing in these five decisions even suggests that the Court must find a breach of the trust prior to testing the transferee's BFP status.

Based thereon, there was absolutely no basis on which the Court of Appeals could simply dispense with a proper examination of the clear fact issues involved in testing the Factors' BFP status. The Court's ruling now allows lower courts within the Ninth Circuit to dispense with a rule of law which controls most of the rest of the country. In addition, the few remaining circuits which have not yet considered this issue will now do so with reference to the Ninth Circuit's opinion as precedent. Due to this clear conflict among the various circuits which the Court's ruling has now created, Petitioners respectfully submit this Court's intervention is necessary to resolve this conflict.

II. The Issue Of Whether A Factor's Status As A Bona Fide Purchaser Is Tested At The Time Of Contract Or The Time Of Collection Of PACA Trust Assets Is An Important Question Of Federal Law Which Should Be Settled By The Supreme Court.

In addition, the element which causes this matter to rise to the level of importance requiring the Supreme Court's involvement is the fact that the Court of Appeals' opinion amounts to a substantial erosion, if not *de facto* repeal, of the very purpose for which Congress enacted the PACA trust amendments in 1984. It is worth noting that Congress did not bury the intent behind these amendments deep in the annals of the Federal Register. Congress took the much bolder step of clearly, unambiguously and emphatically stating its purpose within the enacted text of the statute itself, and in the first paragraph thereof, stating:

> (1) [i]t is hereby found that a burden on commerce in perishable agricultural commodities is caused by financing arrangements under which commission merchants, dealers, or brokers, who have not made payment for perishable agricultural commodities purchased . . . *encumber or give lenders a security interest in* such commodities . . . and *any receivables* or proceeds from the sale of such commodities or products, and that *such arrangements are contrary to the public interest*. This subsection is intended to remedy such burden on commerce in perishable agricultural commodities and to protect the public interest.

7 U.S.C. § 499e(c)(1)(emphasis added). Moreover, each of

the circuits having previously considered the issue of whether a factor can take PACA trust assets ahead of unpaid PACA trust beneficiaries has noted this stated purpose in connection with its ruling on the issue. *Endico*, 67 F.3d at 1067; *Consumers Produce*, 16 F.3d at 1379; *C.H. Robinson*, 952 F.2d at 1316.

The factoring agreement at issue in this case appears, on its face, to be precisely the type of "financing arrangement" which Congress held to be a burden on commerce and contrary to the public interest. However, the Court of Appeals did not even address Congress' stated purpose. In fact, the Court's opinion condones the very conduct which this statute sought to prevent. Moreover, by beginning and ending its analysis with its conclusion that the mere execution of the factoring agreement in this case did not constitute a *per se* violation of the PACA trust, the Court of Appeals went far beyond simply deciding the issues before it in this matter. Instead, what the Court has done is to provide circuit-level precedent for the argument that all a court need do when confronted with a "financing arrangement" which, on its face, conflicts with the stated purpose of the PACA trust amendments is to determine whether the arrangement is "commercially reasonable," and, if so, to end its analysis at that point. Such a result simply cannot be what Congress intended. Indeed, it is hard to imagine Congress would have stated its purpose so prominently and, at the same time, countenanced a result which so clearly undercuts this stated purpose. This is especially true in light of the lack of any other circuit-level decision endorsing such a result, much less such a myopic analysis.

Based thereon, Petitioners respectfully submit the intervention of this Court is necessary to decide this important question concerning the interpretation and judicial

implementation of Congressional intent as stated in the PACA.

CONCLUSION

The Court of Appeals, in affirming the judgment of the District Court, employed a flawed analysis of the facts before the Court. The resulting rule of law is now at odds with every prior circuit-level decision considering the issue of a secured lender's attempt to retain PACA trust assets ahead of PACA trust beneficiaries. By establishing a new standard that allows lenders to avoid a BFP analysis simply by finding their "financing arrangements" were "commercially reasonable," the Court of Appeals established appellate precedent which conflicts with the holdings of at least three other circuits. Therefore, the intervention of the Supreme Court is necessary to resolve this conflict between the circuits which the Court's opinion has created. Moreover, the Court's opinion brings about a result which is so clearly contrary to Congress' stated purpose in enacting the PACA trust amendments that this ruling constitutes an important federal issue which requires this Court's intervention to provide for a consistent standard throughout the country.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[Filed June 4, 2001]

No. 99-56770

BOULDER FRUIT EXPRESS, CONTINENTAL SALES CO., HEATH & LEJEUNE, HEGER ORGANIC FARM SALES, MOUNTAIN GOLD, INC., NATURAL SELECTION FOODS, LLC, NEW HARVEST ORGANICS, PACIFIC ORGANIC PRODUCE, S.A., AMERICAN 4-STAR MARKETING, INC., d/b/a RAINBOW VALLEY ORCHARDS, SUNDANCE NATURAL FOODS, Plaintiffs-Appellants,	)
v.	)
TRANSPORTATION FACTORING, INC., d/b/a Transfac, and CAPITAL RESOURCE FUNDING, INC., Defendants-Appellees.	)

Appeal from the United States District Court
Central District of California, Los Angeles
Case No. 97-4390 SVW (AJWX)
Stephen V. Wilson, District Judge

Before: Glenn L. Archer, Jr.,[1] n1 Stephen S. Trott and Barry G. Silverman, Circuit Judges. Opinion by Judge Silverman.

OPINION

I. Background

This case concerns the Perishable Agricultural Commodities Act (PACA), *7 U.S.C.* § § *499a*-499t (2000). Appellants[2] are growers of fresh fruits and vegetables. From April 1996 to April 1997, appellant growers sold perishable goods to Certified Organics[3] on credit. Certified was in the business of purchasing fresh agricultural produce from growers for resale. Certified resold the produce and invoiced its customers, creating accounts receivable. Certified then sold its accounts receivable to Transportation Factoring, Inc. (Transfac) pursuant to a factoring agreement. Under that agreement, Transfac purchased the accounts from Certified for 80% of their face value.

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[1] The Honorable Glenn L. Archer, Jr., Senior United States Circuit Judge for the Federal Circuit, sitting by designation.

[2] Appellants include Boulder Fruit Express, Continental Sales Company, Health & Lejeune, Heger Organic Farm Sales, Gold, Inc., Natural Selection Foods, LLC., New Harvest Organics, Pacific Organic Produce, S.A., American 4-Star Marketing, Inc., d/b/a Rainbow Valley Orchards, and Sundance Natural Foods.

[3] Certified is not a party to this appeal and this case was proceeding in district court against Certified and Messing when the notice of appeal was filed.

When Certified defaulted in its payments to the growers, the growers sued not only Certified but also Transfac. Why Transfac? The growers allege that Certified's factoring of its accounts to Transfac breached a statutory trust created by PACA for the benefit of the growers. They allege that Certified was to have held the accounts receivable in trust for the growers until the growers were paid for their produce. They allege that in factoring Certified's accounts receivable, Transfac acquired "trust assets" -- the receivables -- in breach of the trust and must disgorge them to the growers, unless Transfac can prove that it was a bona fide purchaser for value without notice of the breach. The growers also sued Capital Resource Funding, Inc., another factoring company that referred Certified's business to Transfac.

On motion for summary judgment, the district court granted summary judgment for Transfac and Capital Funding. The court ruled that because Transfac had paid Certified more for the accounts ($3.297 million) than Transfac collected on them ($3.278 million), albeit less than the face value of the accounts ($4.7 million), Certified's factoring of its accounts did not breach the trust. In other words, because Transfac bought the accounts for at least what they were worth, maybe more, the factoring arrangement did not dissipate trust assets, and therefore, Transfac cannot be found to have acquired the accounts in breach of the trust.

The district court entered judgment in favor of Transfac and Capital Resource Funding pursuant to Fed. R. Civ. P. 54(b). Other claims against Certified and John Messing, Certified's principal, were not resolved by the summary judgment motion.

We have jurisdiction under *28 U.S.C. § 1291*, and review the district court's grant of summary judgment de novo. *Balint v. Carson City, 180 F.3d 1047, 1050 (9th Cir. 1999)* (en banc). We affirm.

II. Discussion

A. PACA.

Congress enacted PACA in 1930 to prevent unfair business practices and promote financial responsibility in the fresh fruit and produce industry. See *Sunkist Growers, Inc. v. Fisher, 104 F.3d 280, 282 (9th Cir. 1997)* (citing *Farley & Calfee, Inc. v. USDA, 941 F.2d 964, 966 (9th Cir. 1991))*. In 1984, Congress amended PACA "to remedy [the] burden on commerce in perishable agricultural commodities and to protect the public interest" caused by accounts receivable financing arrangements that "encumber or give lenders a security interest" in the perishable agricultural commodities superior to the growers. *7 U.S.C. § 499e*(c)(1). Section 499e(c) created the PACA trust:

> Perishable agricultural commodities received by a commission merchant, dealer, or broker in all transactions, and all inventories of food or other products derived from perishable agricultural commodities, and any receivables or proceeds from the sale of such commodities or products, shall be held by such commission merchant, dealer, or broker in trust for the benefit of all unpaid suppliers or sellers of such commodities or agents involved in the transaction, until full payment of the sums owing in connection with such

> transactions has been received by such unpaid suppliers, sellers, or agents.

Id. at § 499e(c)(2); see also *7 C.F.R. § 46.46* (2000). As explained by the Second Circuit:

> This provision imposes a "nonsegregated floating trust" on the commodities and their derivatives, and permits the commingling of trust assets without defeating the trust. Through this trust, the sellers of the commodities maintain a right to recover against the purchasers superior to all creditors, including secured creditors.

Endico Potatoes, Inc. v. CIT Group/Factoring, Inc., 67 F.3d 1063, 1067 (2d Cir. 1995) (citations omitted).

By the express language of PACA, the trust applies to receivables generated by the sale of commodities, just as it does to the commodities themselves. *7 U.S.C. § 499e*(c)(2); *7 C.F.R. § 46.46*. It is designed to protect commodity producers against secured lenders. In the ordinary case, here is how it works: Farmer sells oranges on credit to Broker. Broker turns around and sells the oranges on credit to Supermarket, generating an account receivable from Supermarket. Broker then obtains a loan from Bank and grants Bank a security interest in the account receivable to secure the loan. Broker goes bankrupt. Under PACA, Broker is required to hold the receivable in trust for Farmer until Farmer was paid in full; use of the receivable as collateral was a breach of the trust. Therefore, Farmer's rights in the Supermarket receivable are superior to Bank's. In fact, as a

trust asset, the Supermarket receivable is not even part of the bankruptcy estate.

That's the easy case. The issue today concerns factoring, the commercial practice of converting receivables into cash by selling them at a discount. BLACK'S LAW DICTIONARY (7th ed. 1999). The question before us is whether Certified breached the PACA trust by selling its accounts to Transfac pursuant to the factoring agreement.

We apply general trust principles to questions involving the PACA trust, unless those principles directly conflict with PACA. *Sunkist, 104 F.3d at 282.* The Restatement of Trusts defines a breach of trust as "a violation by the trustee of any duty which as trustee he owes to the beneficiary. "RESTATEMENT (SECOND) OF TRUSTS § 201 (1959). Federal regulations set forth a PACA trustee's primary duty:

> Commission merchants, dealers and brokers are required to maintain trust assets in a manner that such assets are freely available to satisfy outstanding obligations to sellers of perishable agricultural commodities. Any act or omission which is inconsistent with this responsibility, including dissipation of trust assets, is unlawful and in violation of [PACA]

7 C.F.R. § 46.46(d)(1). The regulations further define "dissipation" as "any act or failure to act which could result in the diversion of trust assets or which could prejudice or impair the ability of unpaid suppliers, sellers, or agents to recover money owed in connection with produce

transactions." Id. § 46.46(a)(2).

B. Factoring agreements do not per se breach the PACA trust.

In this case, the growers argue that factoring agreements per se breach the PACA trust because, by definition, they contemplate the sale of trust receivables at less than their face value. However, nothing in PACA or the regulations prohibits PACA trustees from attempting to turn receivables into cash by factoring. To the contrary, a commercially reasonable sale of accounts for fair value is entirely consistent with the trustee's primary duty under PACA and *7 C.F.R. § 46.46(d)(1)* -- to maintain trust assets so that they are "freely available to satisfy outstanding obligations to sellers of perishable commodities." The goal of PACA, after all, is not the perpetuation of unliquidated commercial paper, but to assure that growers are paid for their commodities. H.R. Rep. No. 98-543, at 3 (1983), reprinted in 1983 U.S.C.C.A.N. 405, 406; *Sunkist, 104 F.3d at 282.* Of course, whether a particular factoring arrangement is commercially reasonable will depend upon its terms. A PACA trustee who sells accounts for pennies on the dollar, just to turn a quick buck, might well have breached the PACA trust, while a trustee who factors accounts at a commercially reasonable rate would not. Cf. *E. Armata, Inc. v. Platinum Funding Corp.*, 887 F. Supp. 590, 593 (S.D. N.Y. 1995) (accounts receivable factored at 60 to 65% of face value were not factored for value). We hold that factoring agreements do not, per se, violate PACA.

Our view that factoring agreements do not per se violate the PACA trust is consistent with general trust

principles. Generally, a trustee can sell trust assets unless the sale breaches the trust. RESTATEMENT (SECOND) OF TRUSTS § 190. Whether a transferee of trust assets is a bona fide purchaser becomes relevant only as a defense after it has been determined that a breach of trust has occurred. See id. at § 284(1); *Albee Tomato, Inc. v. A.B. Shalom Produce Corp.*, 155 F.3d 612, 615 (2d Cir. 1998); *Gargiulo v. G.M. Sales, Inc.*, 131 F.3d 995, 999 (11th Cir. 1997); *Endico Potatoes*, 67 F.3d at 1067; *Consumers Produce Co. v. Volante Wholesale Produce, Inc.*, 16 F.3d 1374, 1380 (3d Cir. 1994); *C.H. Robinson Co. v. Trust Co. Bank*, 952 F.2d 1311, 1313 (11th Cir. 1992).

C. This particular factoring arrangement did not breach the PACA trust.

Appellant growers argue in the alternative that, even if factoring agreements do not per se violate PACA, the factoring agreement in this case breached the trust by dissipating the trust assets because Transfac did not pay face value for the receivables. Transfac responds that the factoring arrangement here actually enhanced the trust because it was commercially reasonable. We agree with Transfac.

The factoring agreement allowed Certified to convert invoices that were not payable for 30 days (including uncollectible and invalid invoices) into cash that Certified could have used to immediately pay growers. Far from dissipating assets, Certified actually received from Transfac $ 18,482 more for the accounts than the accounts would prove to be worth. In any case, a factoring discount of 20% was never shown to be commercially unreasonable.

The growers argue that Certified necessarily admitted a breach of the trust when it admitted that it was unable to pay its growers and suppliers of produce. The growers confuse breach of contract with breach of trust. The only question in this case is whether Certified breached its duty as a trustee when it sold the accounts receivable to Transfac. Certified's contractual obligation to pay is not in issue. To the extent that the growers argue that Transfac, as a transferee of trust assets, is strictly liable to the growers because Certified, the transferor, has failed to pay, we already have held that third parties are not guarantors of the PACA trust. They are liable only if they had some role in causing the breach or dissipation of the trust. *Sunkist, 104 F.3d at 283;* see also *Consumers Produce*, 16 F.3d at 1381-82.

To reiterate, in this case, Transfac paid Certified more for trust assets than those assets were worth.
Finally, we agree with the district court that the growers never proved that the trust funds were misapplied in the first place. The growers conceded that they did not know how Certified spent the funds it received from Transfac. If, for example, the funds were used to pay off other perishable commodities producers, no breach of the trust would have occurred. This is because the PACA trust, by definition, is a nonsegregated floating trust in which assets of other growers can be commingled. *7 U.S.C.* § *499*(e)(c).

III. Conclusion

In summary, we hold that factoring does not, per se, breach a PACA trust. We also hold that the particular factoring arrangement in this case was commercially reasonable and did not breach or otherwise dissipate the trust.

The judgment of the district court in favor of Transfac and Capital Resource Funding[4] is AFFIRMED.

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[4] Capital Resource Funding's liability, if any, was predicated upon and solely derivative of Transfac's.

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

Filed September 24, 1999

CV 97-4390 SVW (AJWx)

BOULDER FRUIT EXPRESS, CONTINENTAL SALES CO., HEATH & LEJEUNE, HEGER ORGANIC FARM SALES, MOUNTAIN GOLD, INC., NATURAL SELECTION FOODS, LLC, NEW HARVEST ORGANICS, PACIFIC ORGANIC PRODUCE, S.A., AMERICAN 4-STAR MARKETING, INC., d/b/a RAINBOW VALLEY ORCHARDS, SUNDANCE NATURAL FOODS, Plaintiffs,	)
v.	)
JOHN A. MESING, individually and d/b/a CERTIFIED ORGANICS, TRANSPORTATION FACTORING, INC., CAPITAL RESOURCE FUNDING, INC., FIRST INTERSTATE BANK (LA), LUKE PATRUNO, JR., and WESTERN MIXERS, INC., Defendants.	)

ORDER AMENDING JUDGMENT

The Court entered summary judgment in favor of Defendants Transportation Factoring, Inc. ("Transfact") and

Capital Resource Funding, Inc. ("CRF"). Plaintiffs stipulated to the dismissal of the remaining defendants without prejudice. The Court then entered judgment in favor of Transfac and CRF.

Plaintiffs appealed the Court's decision granting Transfac and CRF summary judgment. The United States Court of Appeals for the Ninth Circuit issued an order citing *Dannenberg v. Software Toolworks, Inc.*, 16 F.3d 1073 (9th Cir. 1994), and indicating that it lacked jurisdiction because some of the defendants were dismissed without prejudice. Plaintiffs subsequently circulated a new stipulation among the various parties to dismiss the remaining defendants with prejudice. Transfac and CRF, however, refused to sign the stipulation.

Dannenberg holds that the dismissal of claims without prejudice does not transform a summary judgment decision into a final and appealable order unless the remaining claims are derivative of the adjudicated claims. *Id.* at 1076. The Dannenberg Court noted that the appellant in such a case could either dismiss its remaining claims with prejudice or procure Rule 54(b) certification from the district court. See *id.* at 1078.

The Court has no objection to certifying its decision to allow Plaintiffs an opportunity to appeal. The judgment entered on October 1, 1998 is amended to read as follows:

The Court hereby enters judgment in favor of Defendants Transportation Factoring, Inc. and Capital Resource Funding, Inc. Plaintiffs shall take nothing as against Transportation Factoring, Inc. and Capital Resource Funding,

Inc. The Court certifies pursuant to Federal Rule of Civil Procedure 54(b) that there is no just reason for delay, and that this judgment is final as to Transportation Factoring, Inc. and Capital Resource Funding, Inc.

IT IS SO ORDERED.

DATED:9/24/99

/S/_____
STEPHEN V. WILSON
UNITED STATES DISTRICT JUDGE

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

Filed October 1, 1998

CV 97-4390 SVW (AJWx)

BOULDER FRUIT EXPRESS, CONTINENTAL SALES CO., HEATH & LEJEUNE, HEGER ORGANIC FARM SALES, MOUNTAIN GOLD, INC., NATURAL SELECTION FOODS, LLC, NEW HARVEST ORGANICS, PACIFIC ORGANIC PRODUCE, S.A., AMERICAN 4-STAR MARKETING, INC., d/b/a RAINBOW VALLEY ORCHARDS, SUNDANCE NATURAL FOODS, Plaintiffs,	)
v.	)
JOHN A. MESING, individually and d/b/a CERTIFIED ORGANICS, TRANSPORTATION FACTORING, INC., CAPITAL RESOURCE FUNDING, INC., FIRST INTERSTATE BANK (LA), LUKE PATRUNO, JR., and WESTERN MIXERS, INC., Defendants.	)

ORDER

This action came on for hearing before the court on April 27,

1998, the Honorable Stephen V. Wilson, District Judge presiding, on motions for summary judgment brought by defendant Transportation Factoring, Inc. d/b/a Transfac ("Transfac") and Capitol Resource Funding, Inc. ("CRF"). The evidence having been fully considered, the issues having been duly heard and a decision having been duly rendered as set forth in the court's Order Granting Transfac's Motion for Summary Judgment and CRF's Motion for Summary Judgment, filed on May 5, 1998,

IT IS HEREBY ORDERED AND ADJUDGED that plaintiffs take nothing as against defendants Transfac and CRF, and that plaintiffs' action be dismissed on the merits as against Transfac and CRF, that the remaining defendants be dismissed per the Stipulation re Dismissals of Defendants Following Order on Motions for Summary Judgment filed on September 18, 1998.

DATED: 10/1/98

/s/_____
Stephen V. Wilson
UNITED STATES DISTRICT JUDGE

APPENDIX D

UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

Filed May 5, 1998

CV 97-4390 SVW (AJWx)

BOULDER FRUIT EXPRESS, CONTINENTAL SALES CO., HEATH & LEJEUNE, HEGER ORGANIC FARM SALES, MOUNTAIN GOLD, INC., NATURAL SELECTION FOODS, LLC, NEW HARVEST ORGANICS, PACIFIC ORGANIC PRODUCE, S.A., AMERICAN 4-STAR MARKETING, INC., d/b/a RAINBOW VALLEY ORCHARDS, SUNDANCE NATURAL FOODS,
Plaintiffs,
v.

JOHN A. MESING, individually and d/b/a CERTIFIED ORGANICS, TRANSPORTATION FACTORING, INC., CAPITAL RESOURCE FUNDING, INC., FIRST INTERSTATE BANK (LA), LUKE PATRUNO, JR., and WESTERN MIXERS, INC.,
Defendants.

ORDER GRANTING TRANSFAC'S MOTION FOR SUMMARY JUDGMENT AND CRF'S MOTION FOR SUMMARY JUDGMENT

I. BACKGROUND

This case is governed by the Perishable Agricultural Commodities Act ("PACA"). Plaintiffs in this case are growers of perishable goods. Defendants fall into two categories. First, there are the purchasers of the perishable goods, namely John Mesing and Certified Organics. The second group consists of two factors, Transportation Factoring ("Transfac") and Capitol Resource Funding ("CRF").

The following facts are not in dispute. Certified is in the business of purchasing perishable goods from growers and reselling the goods for a profit. When Certified resells the goods on credit, it generates accounts receivable. In September of 1995, Transfac and Certified entered into a factoring agreement ("Agreement"), which Transfac terminated in April of 1997.(See Declaration of Sally Thompson in Support of Transfac's Motion for Summary Judgment, filed March 31, 1998 ("Thompson's Transfac Decl."), PP 2, 15, Exh. A). Pursuant to the Agreement, Certified either sold its account receivable to Transfac, or pledged them as collateral for loans advanced by Transfac. In return, Transfac paid Certified 80% of the face value of the receivables. Transfac would then forward the remaining funds, less its fees, once it collected on the receivable from the underlying account debtor. Transfac also had the right to charge back against Certified uncollectible receivables. During the 20-month duration of the Agreement, Transfac paid Certified $ 3,297,244, and obtained receivables having a face value of $ 4,763,213. Transfac was able to collect $ 3,278,761 from the underlying account debtors. (Id. PP 5, 6).

From April of 1996 to April of 1997, Plaintiffs sold perishable goods to Certified on credit. Some of the accounts receivable that Certified factored to Transfac during this period of time were generated when Certified resold goods on credit that it had purchased from Plaintiffs. When Certified subsequently defaulted on its payments to Plaintiffs, Plaintiffs sued Certified, Transfac, and CRF, alleging violations of PACA. (CRF's involvement is described infra Part II.C.). Plaintiffs, Transfac, and CRF have filed cross-motions for summary judgment.

II. LEGAL ANALYSIS

In 1930, Congress enacted the Perishable Agricultural Commodities Act ("PACA"), *7 U.S.C.* § § *499a*-499s (1980). In 1984, to remedy the problem of unpaid sellers, Congress amended PACA by creating a statutory trust in favor of sellers:

> Perishable agricultural commodities received by a commission merchant, dealer, or broker in all transactions, and all inventories of food or other products derived from perishable agricultural commodities, and any receivables or proceeds from the sale of such commodities or products, shall be held by such commission merchant, dealer, or broker in trust for the benefit of all unpaid suppliers or sellers of such commodities or agents involved in the transaction, until full payment of the sums owing in connection with such transactions has been received by such unpaid suppliers, sellers, or agents.

7 U.S.C. § *499e*(c)(2) (Supp. 1998). Pursuant to the regulations promulgated by the Secretary of Agricultural ("Secretary"), trust assets are to be preserved as a "nonsegregated 'floating' trust" whereby commingling of trust assets is permitted. *7 C.F.R.* § *46.46(b)*. In the present case, the res of the trust consists of the perishable goods that Certified purchased from Plaintiffs, the accounts receivable that Certified generated by reselling those goods to third parties on credit, and the proceeds that Certified received from Transfac under the Agreement.

Although not expressly stated in PACA, courts have invariably held that the trust created by PACA is governed by general trust principles. See, e.g., *Gargiulo v. G.M. Sales, Inc.*, 131 F.3d 995, 999 (11th Cir. 1997); *Sunkist Growers, Inc. v. Fisher*, 104 F.3d 280, 282 (9th Cir. 1997); *Endico Potatoes, Inc. v. CIT Group/Factoring, Inc.*, 67 F.3d 1063, 1067 (2d Cir. 1995). The courts regularly rely on the Restatement of Trusts for general trust principles.

A. Transfac's and Plaintiffs' Cross-Motions for Summary Judgment

Transfac's offers three independent arguments why the Court should grant summary judgment in its favor: (1) Certified did not breach the PACA trust; (2) Transfac paid more for the receivables than it was able to collect on them; and (3) as to some of Plaintiffs' claims, Plaintiffs did not comply with the PACA requirements that would entitle them to trust protection.

Transfac first argues that there was no breach of the PACA trust, and therefore, Transfac cannot be held liable to

Plaintiffs for receipt of trust assets. "A breach of trust is a violation by the trustee of any duty which as trustee he owes to the beneficiary." Restatement (Second) of Trusts § 201 (1959) [hereinafter "Restatements Second"]. The primary duty of the trustee is articulated in the regulations promulgated by the Secretary:

> Commission merchants, dealers and brokers are required to maintain trust assets in a manner that such assets are freely available to satisfy outstanding obligations to sellers of perishable agricultural commodities. Any act or omission which is inconsistent with this responsibility, including dissipation of trust assets, is unlawful and in violation of [PACA].

7 C.F.R. § 46.46(d)(1). "Dissipation" is defined as "any act or failure to act which could result in the diversion of trust assets or which could prejudice or impair the ability of unpaid suppliers, sellers, or agents to recover money owed in connection with produce transactions." Id. § 46.46(a)(2). Under the Restatements Second, if there is no breach of trust, then a transferee of trust assets cannot be held liable:

> If the trustee transfers trust property to a third person or creates a legal or equitable interest in the subject matter of the trust in a third person, and the trustee in making the transfer or in creating the interest does not commit a breach of trust, the third person holds the interest so transferred or created free of the trust, and is under no liability to the beneficiary.

Restatement Second § 283.

As applied to this case, there are two ways in which Certified could have breached the PACA trust. First, Certified may have misapplied trust assets by using those assets for purposes other than paying the growers. Second, Under the Agreement, Certified may have received proceeds that were less than the value of the receivables sold or pledged to Transfac, thereby dissipating those assets.

1. Misapplication of Trust Assets

Transfac argues that Plaintiffs have offered no evidence that Certified or Mesing misapplied trust assets. From the mere fact that Certified was unable to pay Plaintiffs, one cannot necessarily conclude that assets were misapplied. An equally plausible explanation is that the proceeds that Certified received from the Agreement were simply insufficient to satisfy its debts to Plaintiffs. Mesing's declaration, submitted by Plaintiffs, supports Transfac's argument that Mesing was not misapplying any trust assets.

> By the middle of 1996, Certified could not meet its obligations to Produce suppliers and, at the same time, continue under the factoring agreement due to the insufficient amounts of cash which Transfac remitted back to certified to meet its financial obligations to its growers as they became due.

(Declaration of John Mesing in Support of Plaintiffs' Motion for Summary Judgment, filed March 31, 1998 ("Mesing Decl."), P 36). Furthermore, Plaintiffs conceded at the April

27, 1998 hearing that it did not know how Certified spent the proceeds it received pursuant to the Agreement. Accordingly, Plaintiffs have not created a genuine issue of fact that Certified or Mesing misapplied PACA trusts assets in breach of the trust.

2. Factoring Agreement

The second way in which Certified could have breached the trust is if, under the Agreement, the value of the receivables sold or pledged to Transfac was less that the funds that Certified received from Transfac in exchange. Conversely, if Transfac paid into the trust an amount equal to or greater than the value of the receivables that it obtained in exchange, there would be no breach of trust. In such a case, the value of the trust assets would have remained unchanged or would have appreciated. Thus, Certified would not have "dissipated" trust assets because the factoring agreement would not have "prejudice[d] or impair[ed] the ability of unpaid suppliers, sellers, or agents to recover money owed."

The primary disagreement between the parties revolves around the definition of "value." Transfac reasons that by liquidating Certified's otherwise illiquid receivables, Transfac actually assisted Certified in meeting its obligations to pay the growers (beneficiaries) as required by PACA. Transfac further argues that because the amount that Transfac paid for the receivables exceeds the amount that Transfac was able to collect on the receivables, there was no dissipation of trust assets. Thus, Transfac concludes, Certified did not breach the PACA trust by factoring the receivables to Transfac.

In response, Plaintiffs argue that because Certified

sold or pledged the receivables for a discount of their face value, Certified breached the trust. Plaintiffs rely on two district court cases for this proposition. See *E. Armata, Inc. v. Platinum Funding Corp.*, 887 F. Supp. 590 (S.D.N.Y. 1995); *Post & Taback, Inc. v. Merrill Lynch Business Financial Services, Inc.*, 859 F. Supp. 757 (S.D.N.Y. 1994). In *E. Armata*, the factor either purchased accounts receivable from the wholesaler (trustee), or loaned money against the receivables. The parties agreed to an advance rate of 60-65% of face value of the receivables. When the wholesaler defaulted on its payments to the growers, the growers sued the factor. The factor's defense was that it was a bona fide purchaser for value. In rejecting that defense, the Court stated:

> Under the facts, the PACA trustee . . . was not transferring the accounts for value but at a discount to raise funds and expand the business of the trustee rather than to maintain assets that could satisfy the fund's obligations.

E. Armata, 887 F. Supp. at 594. This statement illustrates the stark difference between the two cases.

In *E. Armata*, there was evidence that the trustee was using the proceeds from the factoring agreement for purposes other than paying the growers, thereby breaching the trust. In contrast, as explained above, Plaintiffs have offered no evidence that Certified used the proceeds of the Agreement for any purpose other than paying Plaintiffs. Thus, *E. Armata* is easily distinguished.

Post & Taback involved similar facts. The factor

purchased accounts receivable from the wholesaler at a discount. When the growers sued the factor upon default by the wholesaler, the factor claimed that it was a bona fide purchaser for value. The Court disagreed:

> A breach occurred in the present case not simply because a sale was made, but because the sale was made at a discount to raise funds for the trustee . . . rather than to maintain assets that could satisfy Western's obligations to unpaid sellers and suppliers. [The factor] should have known that [the wholesaler] was breaching its obligations as trustee when it offered to sell trust property at a discount.

Post & Taback, 859 F. Supp. at 758-59. It is unclear from the facts of this case whether evidence existed showing that the wholesaler was using trusts assets for purposes other than paying the growers.[1] The Court's language that the proceeds were used to "raise funds for the trustee rather than to maintain assets" implies that the wholesaler was misapplying the funds. Moreover, *E. Armata* cites *Post & Taback* for the proposition that it is a breach of trust for a trustee to use trust assets "to raise funds and expand the business of the trustee

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[1] The published opinion addressed only the constitutionality of PACA, not whether there was a breach or whether the factor was a bona fide purchaser for value. In summarizing the procedural history of the case, the Court quoted a portion of a prior unpublished order in which it denied the factor's motion to dismiss. It is difficult to determine the precise facts upon which the Court relied and the analysis that the Court performed in arriving at its decision.

rather than to maintain assets that could satisfy the fund's obligations." *E. Armata*, 887 F. Supp. at 594. Thus, *Post & Taback* appears to be distinguishable on the same ground as *E. Armata*. To the extent that *Post & Taback* holds that it is a per se breach of trust for a trustee to factor accounts receivable at a discount to face value, this Court disagrees.

Plaintiffs ignore economic reality in arguing that the value of a receivable is equal to its face value. In the areas of both bankruptcy and tax, courts have consistently held that the face value of an account receivable may not represent its true value.

> Accounts receivable need not be taken at face value if circumstances cast doubt on their collectibility. The prospects of collection of such assets are evaluated in light of the past record of payment of the obligors, the obligors' current solvency, and the presence or absence of any dispute over the validity of the accounts or debts owed.

Constructora Maza, Inc. v. Banco De Ponce, 616 F.2d 573, 577 (1st Cir. 1980) (bankruptcy); see also *In re Missionary Baptist Foundation of America, Inc.*, 796 F.2d 752, 761 (5th Cir. 1986)("Simply taking the value of accounts receivable as their 'face value' might place an undue burden on [creditors] if . . . the accounts receivable . . . were not or could not in fact be collected in full."); *Bar L Ranch, Inc. v. Phinney*, 426 F.2d 995, 1000 (5th Cir. 1970) ("Although a valuation at face may be a reasonable starting place, such a valuation will be held to be arbitrary if evidence of commercial realities is introduced which shows that the valuation is clearly

excessive."); *Kreps v. Commissioner*, 351 F.2d 1, 10 (2d Cir. 1965)("Bankruptcy courts have not appraised accounts receivable at their face value but have valued them according to the prospect of their collectibility as of a critical date.").

Here, there is uncontroverted evidence that although the face value of the receivables was $4,763,213, Transfac was only able to collect $3,278,761, which is $18,843 less than the $3,297,244 that it paid Certified for the receivables. (Thompson's Transfac Decl., PP 5, 6). Sally Thompson, the Senior Vice President and Operations Manager of Transfac, further declares that although "Transfac followed its usual business practices in attempting to collect on receivables purchased by Transfac,"

> Transfac was unable to collect 100% of Certified's accounts receivable . . . because approximately $ 1,500,000 of the total face amount of the receivables of $ 4,763,213 were either directly collected by Certified and not remitted by Certified to Transfac, were inflated, fraudulent, duplicates of other transactions, fictitious, overstate[ments of] the amount actually due, or otherwise uncollectible by Transfac.

(Supplemental Declaration of Sally Thompson in Support of Transfac's Motion for Summary Judgment, filed April 31, 1998 ("Thompson Supp. Decl."), PP 12, 13).

Transfac maintains that the amount collected by it after expending reasonably diligent efforts represents the fair value of the receivables. That Certified would have liquidated the

receivables in the same manner as did Transfac, i.e., by collecting on them (as opposed to selling them), bolsters this method of valuation. See H. Cohen, "Value" Judgements: Accounts Receivable Financing and Voidable Preferences Under the New Bankruptcy Code, *66 Minn. L. Rev. 639, 664 (1982)* ("value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property"); *In re Missionary Baptist Foundation of America, Inc.*, 796 F.2d 752, 762 (5th Cir. 1986) (citing Cohen with approval).

Other than their rejected argument that the value of the receivables is equal to their face value, Plaintiffs have offered no evidence of valuation to rebut Transfac's assertion. In other words, Plaintiffs have not shown that had Certified retained the receivables, it could have collected more than Transfac was able to collect. Absent this showing, Plaintiffs have not met their burden of establishing a genuine issue of fact that the receivables were worth more than the amount collected by Transfac.

At the April 27 hearing, Plaintiffs offered an alternative argument: that Certified had no right to sell or pledge the full face value of the receivables, but only that amount equal to the profit that Certified made in reselling the goods to third parties. Plaintiffs' reasoning seems to be that the receivables, other than the share representing Certified's profit margin, were not Certified's property, but were Plaintiffs' property. In this respect, Plaintiffs are plainly wrong. It is axiomatic that a trustee is the legal owner of trust assets, while the beneficiaries have only an equitable interest. Furthermore, the trustee has the power to sell and to encumber trust property unless prohibited by the express

language creating the trust. See Restatements (Third) of Trusts § § 190, 191 (Tentative Draft, 1992) [hereinafter "Restatements Third"][2] Nothing in PACA prohibited Certified from selling the receivables to Transfac.

Accordingly, the Court GRANTS Transfac's Motion for Summary Judgment.

B. CRF's and Plaintiffs' Cross-Motions for Summary Judgment

Plaintiffs allege that CRF is also liable for breach of the PACA trust. The following facts do not appear to be in dispute. CRF initially came into contact with Certified in July of 1995 as a potential receivables factoring client. On July 12, 1995, CRF issued a written quotation to Certified for an

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[2] Section 190 of the Restatements Third addresses the trustee's power of sale of trust assets:

The trustee can properly sell trust property unless
(a) the terms of the trust expressly prohibit or condition the sale of some or all of the trust assets, or
(b) it appears from the terms of the trust and the circumstances that assets of the trust are to be retained in specie in the trust estate.

The power to encumber trust property is provided for in § 191, which reads:

Unless prohibited by statute or the terms of the trust, the trustee has power to borrow money and to mortgage, pledge, or otherwise encumber trust property for trust purposes. The trustee is under a duty to exercise caution as well as a duty to exercise care and skill in deciding whether and under what terms to borrow money or encumber trust property.

account receivable factoring facility ("Quotation") (Declaration of David Marrin in Support of CRF's Motion for Summary Judgment, filed March 31, 1998 ("Marrin Decl."), Exh. B). Following execution of the Quotation, in July and August of 1995, CRF undertook a due diligence review of Certified's financial condition. On September 15, 1995, CRF referred the Certified account to Transfac, the terms of which were set forth in a letter.[3] Together with the referral, CRF transmitted to Transfac the documents constituting its due diligence review of Certified. (See Declaration of Sally A. Thompson in Support of CRF's Motion for Summary Judgment, filed March 31, 1998 ("Thompson's CRF Decl."), Exh. A).

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[3] The referral contained the following provisions:

1. The referral is accepted on a temporary basis and at such time CRF may wish to start funding Certified Organics, CRF will be allowed to do so with no costs or penalties incurred by either CRF or Certified Organics.

2. Upon notification by CRF that CRF will begin funding this account, Transfac will cease their [sic] fundings.

3. Transfac will execute and deliver to CRF any and all documents necessary to release and transfer this account to CRF.

4. This account is subject to a broker referral commitment of 10% of any fees from any fundings. Transfac agrees to accept and be bound by this preexisting referral agreement.

(Marrin Decl., Exh. C).

Plaintiffs allege two alternative theories of liability against CRF: (1) CRF is vicariously liable because it entered into a joint venture and/or agency relationship with Transfac for the purpose of acting as a factor for Certified; and (2) CRF itself obtained PACA trust assets.

As for the joint venture/agency theory of liability, CRF's liability is derivative of Transfac's liability. Because the Court has granted summary judgment in favor of Transfac, Plaintiffs' joint venture/agency theory must fail as a matter of law. Therefore, CRF can only be liable if it directly received trust assets in breach of the trust.

Plaintiffs's theory is that Transfac's payment to CRF's of the 10% referral fee constituted receipt of trust assets by CRF. However, CRF asserts that P 4 of the referral pertains to a pre-existing referral commitment with FIC Financial Services ("FIC"). (Thompson's CRF Decl., P 9). CRF maintains, and Transfac confirms through Sally Thompson, that the 10% referral fee was not to be paid, and was not paid, to CRF. After executing the referral, Transfac paid the 10% broker referral fees to FIC. (Id. PP 9, 15). Plaintiffs have offered no evidence that Transfac paid any referral fees or monies of any kind to CRF arising out of or relating to any transactions with Certified. Nor is there any evidence that FIC conferred a benefit upon CRF that was in some manner related to the 10% referral fee.

Finally, Plaintiffs claim that they recently discovered a UCC financing statement filed by CRF that shows that CRF obtained a security interest in Certified's accounts. CRF concedes that they filed the statement, but that it did so during its due diligence effort prior to referring the account to

Certified. CRF correctly points out that the filing of a financing statement does not create a security interest. 9 Anderson on the Uniform Commercial Code § 9-402:6, at 768 (1994). The UCC permits, and indeed encourages, the filing of financial statements before any security interest has been created.

> [Section 9-402 of the UCC] adopts the system of "notice filing which proved successful under the Uniform Trust Receipts Act. What is required to be filed is not, as under chattel mortgage and conditional sales acts, the security agreement itself, but only a simple notice which may be filed before the security interest attaches or thereafter. The notice itself indicates merely that the secured party who has filed may have a security interest in the collateral described.

UCC § 9-402 cmt. P 2. Thus, "if there is no . . . security agreement at the time the financing statement is filed, the financing statement does not create a security interest nor have any effect at that time." Anderson, at 768-69. Plaintiffs have offered no evidence of a security agreement between CRF and Certified.

Because Plaintiffs have produced no evidence that CRF received PACA trust assets, the Court GRANTS CRF's Motion for Summary Judgment.

III. CONCLUSION

For all of the above reasons, the Court GRANTS

Transfac's Motion for Summary Judgment and GRANTS CRF's Motion for Summary Judgment.

IT IS SO ORDERED.

DATED: 5/5/98

/s/_____
STEPHEN V. WILSON
UNITED STATES DISTRICT JUDGE

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[Filed September 18, 2001]

No. 99-56770

BOULDER FRUIT EXPRESS, CONTINENTAL SALES CO., HEATH & LEJEUNE, HEGER ORGANIC FARM SALES, MOUNTAIN GOLD, INC., NATURAL SELECTION FOODS, LLC, NEW HARVEST ORGANICS, PACIFIC ORGANIC PRODUCE, S.A., AMERICAN 4-STAR MARKETING, INC., d/b/a RAINBOW VALLEY ORCHARDS, SUNDANCE NATURAL FOODS,
Plaintiffs-Appellants,
v.
TRANSPORTATION FACTORING, INC., d/b/a Transfac, and CAPITAL RESOURCE FUNDING, INC.,
Defendants-Appellees.

Appeal from the United States District Court
Central District of California, Los Angeles
Case No. 97-4390 SVW (AJWX)
Stephen V. Wilson, District Judge

Before: Glenn L. Archer, Jr.,[1] Stephen S. Trott and Barry G. Silverman, Circuit Judges. Opinion by Judge Silverman.

The panel has voted to deny Appellants' petition for rehearing and to reject the petition for rehearing en banc.

The full court has been advised of the petition for rehearing en banc and no active judge has requested a vote on whether to rehear the matter en banc. Fed.R.App.P. 35.

The petition for rehearing is denied and the petition for rehearing en banc is rejected.

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[1] The Honorable Glenn L. Archer, Jr., Senior United States Circuit Judge for the Federal Circuit, sitting by designation.